United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7404

To be argued by
SIDNEY J. SILBERMAN

United States Court of Appeals
For the Second Circuit

ARNOLD MARSHEL,
Plaintiff-Appellant,
v.
AFW FABRIC CORP., CONCORD FABRICS INC.,
ALVIN WEINSTEIN and FRANK WEINSTEIN,
Defendants-Appellees.

BARRY L. SWIFT,
Plaintiff-Appellant,
v.
CONCORD FABRICS INC., AFW FABRIC CORP.,
ALVIN WEINSTEIN and FRANK WEINSTEIN,
Defendants-Appellees.

Appeal from Order of the United States District Court
for the Southern District of New York
Denying Preliminary Injunction

BRIEF OF DEFENDANTS-APPELLEES

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Issue Presented for Review

Did the district court abuse its discretion in denying plaintiffs' motions for a preliminary injunction against the merger of AFW Fabric Corp. and Concord Fabrics Inc.,

the purpose of which is to return Concord to a privately-held corporation, where the motions were based on the claims that the merger would violate Rule 10b-5 under the Securities Exchange Act of 1934 (the "1934 Act") and would constitute a breach of fiduciary duty under New York common law, but the terms, purpose and consequences of the merger were fully and accurately disclosed to Concord's public stockholders in full compliance with the proxy rules issued under the 1934 Act, the merger is specifically authorized by the New York Business Corporation Law, and all dissenting stockholders have the right to obtain a judicial determination of the value of their stock in an appraisal proceeding under the New York Statute?

Preliminary Statement

This is an appeal by plaintiffs* from an order of the United States District Court for the Southern District of New York (MacMahon, J.), dated June 24, 1975,** which denied plaintiffs' motions for a preliminary injunction against a proposed merger of AFW Fabric Corp. into Concord Fabrics Inc., a publicly-held corporation the stock of which is listed on the American Stock Exchange. The purpose of the merger is to return Concord to private ownership by defendants Alvin and Frank Weinstein and their family, who now own 68% of the stock. This is to be accomplished by paying cash, at the rate of $3 a share, to the public stockholders, as permitted by the New York

* For convenience, plaintiffs-appellants are referred to in this brief as "plaintiffs" and defendants-appellees as "defendants".

** The Court's opinion, which is not yet officially reported, appears in CCH Fed. Sec. L. Rep. ¶95,219.

merger statute; the $3 price is 70% higher than the highest price at which the stock had been selling in the market until a few days before the plan was announced.

Plaintiffs are minority stockholders of Concord. The *Marshel* action contains derivative and class claims based on alleged violations of the 1934 Act and of Rule 10b-5 thereunder, together with pendent claims under New York law. The *Swift* action is a diversity action based on New York law only, and is almost identical with the pendent claims in *Marshel*.

The motions for preliminary injunction were argued before Judge MacMahon on March 31, 1975. Consummation of the merger was stayed, upon stipulation of the parties, pending the District Court's decision.

A separate action was commenced in the New York Supreme Court by the Attorney General, seeking to enjoin the merger under New York's blue sky law, or Martin Act. A decision granting a preliminary injunction was handed down on June 11, 1975, and the order entered thereon is now the subject of an appeal to the Appellate Division.

The Facts

Concord Fabrics Inc. ("Concord") is a New York corporation engaged in the business of "converting" textile fabrics. It develops, designs and styles woven and knitted fabrics for sale primarily to apparel manufacturers but also to retailers for resale to the home sewing market. (82).*

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* Numerical references in parentheses are to pages of the Appendix.

Prior to July 1968, Concord was a private corporation owned by defendants Alvin and Frank Weinstein and members of their families. In that month, Concord made an underwritten public offering of 300,000 shares of its common stock at $15 per share and about one year later, in June 1969, Alvin and Frank Weinstein sold to the public through underwriters 200,000 shares of Concord common stock at $20 per share. Thereafter, the public held 32% of Concord's outstanding stock and the Weinstein's held 68%. Since late June 1969, Concord's stock has been listed on the American Stock Exchange. (55, 68-69).

Concord's Recent Financial History

Contrary to plaintiffs' unsupported allegation (Plaintiffs' Brief p. 7), Concord has not "prospered" as a publicly-held company. Although it achieved record earnings in 1968 ($2,215,429) and almost as much in 1969 ($2,066,917), its earnings dropped sharply thereafter. In 1970 Concord earned only $203,684, and for the fiscal years 1971 and 1972 it suffered a combined *loss* of $1,451,349. For fiscal 1973 and 1974 and the first 22 weeks of fiscal 1975 (ended February 2, 1975), Concord earned only $1,109,468—an amount not sufficient to recoup the losses it had sustained in 1971 and 1972. (54-56, 77).

Concord's decline in performance after 1969 was due in part to the volatile nature of the fabric industry and in part to the adverse effects of a major expansion of its knitting operations (including building and equipping a knitting plant at an aggregate cost of approximately $3,800,000) and the leasing of a new, 160,000 square-foot distribution center which was designed to handle an ex-

pected increase in retail volume but which has operated well below capacity and was closed in 1973, resulting in continuing expenses until a new tenant is found for the property (56-58). Concord paid cash dividends of 10¢ a quarter starting in the latter part of 1968, but discontinued them after the first quarter of 1970, at a time when it was committing substantial investments in the knitting plant and distribution center, earnings were falling drastically, the company had short-term bank loans ranging as high as $9,600,000 and a term loan of $8,400,000 was being negotiated (54, 56-58, 77, 82). In the face of the large losses subsequently incurred, dividends were not resumed.

The price of Concord's common stock has reflected its unfavorable earnings record, as well as the general stock market decline in recent years. The stock has never sold higher than $5¼ per share since the beginning of 1973 and never higher than $3¼ since October 1, 1973. For much of the year and a half preceding announcement of the plan for going private, described below, the stock sold for less than $2; indeed, until a few days before the announcement of the proposed $3 per share price, the stock was selling at no more than $1¾. (58, 81).

The Plan to Return Concord to a Privately-Owned Corporation.

On February 6, 1975, Concord announced a plan pursuant to which the corporation would be returned to private ownership by the Weinstein family. The first step in the plan was a tender offer in which AFW Fabric Corp. ("AFW"), a New York corporation that had been formed to effectuate the plan and that had acquired the Wein-

steins' 68% stock interest in Concord, offered to pay $3 per share for each share of Concord's stock held by the public. (48). This was 70% above the highest market price prevailing until a few days before the tender offer was announced, and more than twice the price at which the stock sold for most of the preceding month (58, 81). The tender offer was designed to afford to those Concord stockholders who wished to take advantage of it, the opportunity to be paid for their Concord stock before the consummation of the second step in the plan, a merger of AFW into Concord (48, 50).* Under the terms of the merger, Concord's public stockholders would be paid $3 per share for their stock, subject to assertion of their appraisal rights. Upon the consummation of the merger, the Weinstein family would own all of Concord's outstanding stock. (68-69).

The $3 per share price to be paid to Concord's public stockholders under both the tender offer and the plan of merger was determined by Concord's board of directors after consideration of the price of the stock; the trading activity; the financial position, earnings and prospects of the company; the volatility of the fabric industry; and the opinion of Shearson Hayden Stone Inc., a large, well-known investment banking firm which is the successor to Shearson, Hammill Co., Inc., the principal underwriter of

* In their complaint, plaintiffs allege, on information and belief, that the purpose of the tender offer was to evade the proxy rules of the Securities and Exchange Commission, an unfounded charge which we demonstrate beyond doubt is baseless in both law and fact (see p. 8, *infra*). In their brief on this appeal they have, without any support, embroidered this charge with the added claim that the purpose of the tender offer was to "manipulate" the price and "panic" the public stockholders into tendering, for the purposes stated above. (Plaintiffs' Brief pp. 8-9).

the two public offerings of Concord stock. (72). The officer of Shearson Hayden Stone Inc. who was initially responsible for the preparation of the opinion is the son of one of Concord's directors, Dr. Charles M. Edwards, Jr., Dean Emeritus of the New York University Institute of Retail Management (72, 84), but the opinion, a copy of which is set forth as Exhibit B to the Concord Proxy Statement, is that of Shearson Hayden Stone Inc. (98-99). There is absolutely no basis whatever, in the record or otherwise, for the statement in plaintiffs' brief (p. 12) that the evaluation was not the result of independent analysis by the Shearson firm but was "determined" by Dr. Edwards' son.*

Concord's Proxy Statement and Stockholders' Meeting.

On February 1[illegible], 1975, about two weeks before the institution of the first action to enjoin the tender offer, Concord filed preliminary proxy material with the Securities and Exchange Commission. After comments were received from the SEC and revised material based on the comments was filed and the SEC advised Concord that it had no further comments, the definitive Proxy Statement was mailed on March 17, 1975. (49, 51). The Special Meeting of Concord's stockholders to consider the proposed merger was held on April 10, 1975. The Proxy Statement (66-103) completely and accurately discloses the terms of the proposed merger, its purpose and its consequences to the public shareholders of Concord and to the Weinstein family, and the court below so found (131-132).

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* There is likewise no support for the contention which plaintiffs made below that the evaluation was not an independent one because it was worked on by Dr. Edwards' son. There is not a scintilla of evidence that Dr. Edwards had any interest in influencing the evaluation, or that he attempted to do so, or that he could have done so.

The Proceedings Below.

On February 28, 1975, approximately three weeks after the announcement of the plan to return Concord to a private corporation, plaintiff Marshel commenced an action in the United States District Court for the Southern District of New York to enjoin the tender offer. His fundamental contention was that the purpose of the tender offer was to enable Concord to reduce the number of its public shareholders sufficiently so that it could de-register its stock and thereby avoid compliance with the SEC's proxy rules in connection with the proposed merger. This charge was wholly unfounded both in law and fact. As a matter of law, under the 1934 Act de-registration of Concord's stock could not under any circumstances have been accomplished between the March 5th expiration date of the tender offer and the early April date which had been publicly announced as the scheduled time for the merger (24).* As a matter of fact, Concord, in full compliance with the SEC rules, had filed its preliminary proxy material with the SEC on February 12, 1975, two weeks before the commencement of the *Marshel* action (49).

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* Rule 12d2-2 under the 1934 Act permits a corporation to withdraw the listing and registration of its stock on an exchange only by order of the SEC, upon application either by the exchange or by the issuer in accordance with the rules of the exchange. Rule 18 of the American Stock Exchange requires the issuer to submit detailed reasons in support of an application and authorizes the Exchange to require 15 days' prior notice to all stockholders. After the issuer, having complied with the Exchange's rules, files an application with the SEC, the SEC is required to publish notice of the application in the Federal Register and to give all interested persons an opportunity to submit written comments; the SEC may also order a hearing, and is empowered to determine whether the application should be granted and to impose requirements to protect investors.

As the court below found, the defendants foresaw that there would be attempts to enjoin the merger as well as the tender offer, and since the merger alone would accomplish the result they sought, they withdrew the tender offer on March 3, 1975 in order to avoid unnecessary legal expenses (126). Thereafter, as had been expected, the *Marshel* complaint was amended to include a challenge to the merger on the ground that it constituted a plan to "freeze-out" the public shareholders at unreasonably low prices (¶¶16, 25 and 42) and that, accordingly, it violates Rule 10b-5 under the 1934 Act and the fiduciary duties of the Weinsteins to the public shareholders of Concord under New York common law. The amended complaint (4-32), which was filed before Concord mailed its Proxy Statement, naturally did not allege any material misstatement in, or omission from, the Proxy Statement.

The *Swift* action was originally commenced in the Supreme Court of the State of New York and sought to enjoin the tender offer. After the offer was withdrawn, Swift discontinued his state court action and filed a complaint in the Southern District of New York seeking to enjoin the merger. Like the *Marshel* complaint, the *Swift* complaint (141-156) contains both class and derivative counts alleging that the merger will "freeze out" the public shareholders at unreasonably low prices (¶¶16, 25 and 34) in violation of the fiduciary duties of the Weinsteins to the public stockholders of Concord under New York common law. Indeed, apart from the fact that it alleges jurisdiction based on diversity of citizenship, the *Swift* complaint is almost identical with the pendent claims in the *Marshel*

complaint, repeating verbatim most of its allegations.* As in the *Marshel* action, the *Swift* complaint does not allege that the Proxy Statement was false or misleading.

Plaintiffs in both the *Marshel* and *Swift* actions moved for a preliminary injunction against the proposed merger and their motions were denied by decision and order of the Hon. Lloyd F. MacMahon dated June 24, 1975, CCH Fed. Sec. L. Rep. ¶95,219.** Relying on this Court's decision in *Popkin* v. *Bishop*, 464 F.2d 714 (1972), and the unanimous line of decisions in the Southern District of New York holding that going-private transactions do not by themselves violate Rule 10b-5, the Court held (131):

> "Plaintiffs' claims that there has been a Rule 10b-5 violation because of the unfair and inadequate price to be paid for the Concord shares and the absence of a bona fide corporate purpose for the merger are patently without merit. Rule 10b-5 simply does not encompass these alleged wrongs."

The Court next found that the Proxy Statement "lays bear [sic] the facts of, and the motives for, the merger" (132) and is neither misleading nor fails to disclose any material

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* Plaintiffs (Brief p. 3) attempt to justify the commencement of a duplicative action in the Southern District of New York by reference to Rosenfeld v. Black, 445 F.2d 1337 (2d Cir. 1971), *cert. denied*, 409 U.S. 802 (1972), in which this Court condemned the practice of simultaneously instituting actions in the federal and state courts but certainly did not, either expressly or impliedly, encourage the commencement of multiple actions in the federal courts alleging the same claims for relief.

** Two other actions were commenced in the Southern District of New York by shareholders of Concord: Michaels v. Weinstein, et al., 75 Civ. 1027 LFM; and Krause v. Concord Fabrics Inc., et al., 75 Civ. 1064 LFM. Motions for a preliminary injunction were made and denied in both of those actions and the plaintiffs have not filed appeals.

information (132), and accordingly that there is "little factual substance" to plaintiffs' allegations under Rule 10b-5 (131).

The Court then turned to the state law claim, and held (133):

> "We find plaintiffs' contention that they are entitled to a preliminary injunction for violations of state law equally without merit. Where a merger is to be accomplished in accordance with statutory proceedings, as here, appraisal is the only remedy available to dissenting shareholders." (Footnotes omitted.)

As additional reasons for denying the preliminary injunction, the Court held that plaintiffs will not be irreparably damaged since they "have a 'sufficiently adequate remedy at law' ", and, further, that they "failed to demonstrate that the balance of hardship tips in their favor" (133).

The State Court Action.

On April 7, 1975, subsequent to the commencement of the Federal actions, the Attorney General of the State of New York commenced an action in the New York State Supreme Court to enjoin the proposed merger of AFW and Concord on the ground that it violated the provisions of the New York blue sky law or Martin Act—Article 23-A of the General Business Law. On June 11, 1975, Special Term granted the Attorney General's motion for a preliminary injunction, but the court did not find that the Proxy Statement was in any way false or misleading or that any of the defendants was guilty of any fraud, and

indeed did not find that any New York law had been violated in any respect; the opinion is not entirely clear, and the court may have held merely that an injunction would issue to permit the New York Attorney General further to "scrutinize" the transaction. In any event, defendants believe the decision to be clearly erroneous as a matter of law, and have filed an appeal to the Appellate Division for the month of September, 1975.

ARGUMENT

POINT I

Since Concord's Proxy Statement fully and accurately discloses the terms, purposes and consequences of the proposed merger, the merger does not violate the provisions of Rule 10b-5.

An application for a preliminary injunction is addressed to the discretion of the district court and the denial of plaintiffs' motion below must be affirmed unless plaintiffs demonstrate a clear abuse of discretion. *Hudson Tire Mart, Inc.* v. *Aetna Casualty & Surety Co.*, Docket No. 75-7067 (2d Cir., June 27, 1975); *SCM Corp.* v. *Xerox Corp.*, 507 F.2d 358, 360 (2d Cir. 1974); *Stamicarbon, N.V.* v. *American Cyanamid Co.*, 506 F.2d 532, 536-37 (2d Cir. 1974). As we show below, the law in this Circuit is overwhelmingly and uniformly to the effect that when there has been full and accurate disclosure, a going-private transaction such as the proposed merger in the present case does not violate Rule 10b-5, and that in any event the existence of appraisal rights under state law provides a sufficiently adequate remedy at law so that injunctive

relief will not be granted. Accordingly, the District Court clearly rendered a correct decision and even more clearly did not abuse its discretion.

Rule 10b-5 under the 1934 Act makes it unlawful, in connection with the purchase or sale of a security,

> "(1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

On this appeal, plaintiffs do not claim that there were any untrue statements of material facts or any failures to state material facts concerning the plan to return Concord to a privately-held corporation. In fact there were none, and the District Court expressly so found (131-132). Nor is there any evidence whatever of fraud or deception in any other aspect of the transaction. The complaints allege, on information and belief and without any factual support, that defendants "improperly depressed or deferred" Concord's earnings by "improper inventory markdowns and by unwarranted reserves and by the utilization of other improper accounting practices" (7, 144); defendants, however, conclusively answered these baseless allegations (52-54 and 104-109), and plaintiffs did not press them in the court below and have not done so on this appeal.

Plaintiffs' sole remaining attempt to bring this case within the recognized ambit of Rule 10b-5 is the conclusory allegation that defendants "artificially depressed the market price" of Concord's stock by causing Concord to refrain from paying cash dividends although it "had and continues to have large sums of cash and other liquid assets which are unnecessary for its operation of business" (13, 150). This allegation is on information and belief and the affidavit in support of the *Marshel* motion merely refers to the fact that the complaint makes the charge, but does not itself make the charge (38).

In any event, the charge is patently absurd and was not accepted by the court below. Concord suspended dividends early in 1970, in the face of large commitments for expansion, falling earnings, a high level of short-term bank borrowings, and negotiations for a large long-term loan (see p. 5, *supra*). In the ensuing two years Concord suffered an aggregate net loss of $1,451,349, which it had not yet recouped at the time the proposed merger was announced (54-55, 77). Under these circumstances, the suspension of dividends was probably *required* in the exercise of the sound business judgment of the directors; it certainly was not a wrongful act designed to depress stock prices artificially. Furthermore, even plaintiffs do not suggest that the plan to go private was inaugurated in 1970; the complaints allege that the defendants entered into the plan "commencing sometime prior to January 1975" (10, 146-147).

There is thus no credible claim in the present case of any fraud or deception within the recognized ambit of

Rule 10b-5. Plaintiffs' position on this appeal is therefore reduced to the proposition—which is expressly stated in their brief (pp. 32-33)—that the proposed merger violates Rule 10b-5 and state law solely because there is no business purpose for the merger which will return Concord to private ownership.

We show in Point II that the proposed merger is valid under New York law. As to the Rule 10b-5 claim, six decisions in the Southern District of New York in six separate actions—not a single one of which is cited in plaintiffs' brief on appeal—make it clear that where, as here, there is full disclosure and no material misrepresentation or omission, and the right of minority stockholders to receive the fair value of their stock is assured by appraisal proceedings under state law, there is no violation of Rule 10b-5. *Dreier* v. *Music Makers Group, Inc.*, [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,406 (S.D.N.Y. 1974) (Gagliardi, J.); *Greenberg* v. *Institutional Investor Systems, Inc.*, CCH Fed. Sec. L. Rep. ¶95,231 (S.D.N.Y. 1975) (Owen, J.); *Green* v. *Santa Fe Industries, Inc.*, 391 F. Supp. 849 (S.D.N.Y. 1975) (Brieant, J.); *University Capital Corp.* v. *Barbara Lynn Stores, Inc.* (unreported), 74 Civ. 4460 (S.D.N.Y., October 25, 1974) (Weinfeld, J.); *Tanzer Economic Associates* v. *Haynie*, 388 F. Supp. 365 (S.D.N.Y. 1974) (Frankel, J.); *Kaufmann* v. *Lawrence*, 386 F. Supp. 12 (S.D.N.Y. 1974) (Carter, J.), *aff'd per curiam*, 514 F.2d 283 (2d Cir. 1975).

Dreier v. *Music Makers Group, Inc.*, *supra*, CCH Fed. Sec. L. Rep. ¶94,406, was a purported class action under Rule 10b-5 seeking to enjoin a "going private" merger on

facts almost identical with the present case: an initial public offering by Music Makers in 1967 at $10 a share; a transfer in 1972 of approximately 60% of the stock to a private corporation owned by the transferors; and a proposed merger in which the remaining stockholders of Music Makers were to receive $3 per share in cash. Judge Gagliardi dismissed the complaint insofar as it related to the merger, holding that personal financial gain to the majority or even unfairness to the minority, if fully disclosed, do not give rise to a cause of action under Rule 10b-5. He stated (CCH Fed. Sec. L. Rep. at 95,410):

> "The complaint alleges that the individual defendants effectuated the merger merely to derive a personal financial gain and that the terms of the merger requiring minority shareholders to sell at a price of three dollars per share were grossly unfair. Accepting the truth of these allegations, I find that the complaint fails to state a cause of action under the federal securities laws arising out of the merger transaction * * * [N]on-disclosure remains an essential element in any section 10(b)—Rule 10b-5 action. *Popkin* v. *Bishop*, 464 F.2d 714 (2d Cir. 1972) * * * [P]laintiff's remedy is a state court action for appraisal pursuant to the Delaware Corporation Law."

In *Greenberg* v. *Institutional Investor Systems, Inc.*, *supra*, CCH Fed. Sec. L. Rep. ¶95,231, the defendants consummated a going private transaction in two steps, a tender offer followed by a merger. As a result of the tender offer, the total number of outstanding public stockholders was reduced to less than 300, enabling the company to terminate its SEC registration. Thereafter, in a merger as to which the SEC's proxy rules were not applicable, the remaining stockholders received only cash for their shares. Citing

the decision of the District Court in the present case, and the other Southern District decisions rejecting challenges to going-private transactions under Rule 10b-5, Judge Owen dismissed the complaint and summarized the law as follows:

> "[T]he case law in this District is clearly to the effect that assuming full disclosure has been made there is nothing *per se* illegal under federal law about a merger that eliminates minority public shareholders and similarly, under *Popkin* v. *Bishop*, 464 F.2d 714 (2d Cir. 1971), the federal securities laws are not concerned with whether a merger eliminating public shareholders was fair or unfair or a good or bad transaction."

University Capital Corp. v. *Barbara Lynn Stores, Inc.*, *supra*, 74 Civ. 4460 (unreported), decided October 25, 1974, involved a motion for a preliminary injunction against consummation of a merger between Barbara Lynn Stores, Inc. and Lynbar Corp., a private corporation which was formed by certain individual stockholders of Barbara Lynn for the purpose of the merger and which held 43.8% of the Barbara Lynn stock. The merger, which under Delaware law required only majority approval, called for all stockholders other than Lynbar to receive $4 a share in cash. Judge Weinfeld stated:

> "Given full and adequate disclosure, the question of what is a fair price for the stock is not a question for the Court to decide."

While he found that certain additional disclosures were required, he enjoined consummation of the merger for only two weeks, solely to permit time for this additional disclosure to be made. Had the merger, in eliminating the

public stockholders, by itself violated Rule 10b-5, Judge Weinfeld obviously would not have granted only temporary and limited relief which permitted the merger ultimately to be consummated.

In *Kaufmann* v. *Lawrence, supra*, 386 F. Supp. 12, Judge Carter, finding that there had been no material misrepresentation or omission, denied a motion for preliminary injunction against consummation of an exchange offer by Wells, Rich, Greene, Inc. of cash and debentures for stock held by all persons other than the management group. Relying on this Court's decision in *Popkin* v. *Bishop*, he stated (386 F. Supp. at 17):

> "[T]here is nothing invalid *per se* in a corporate effort to free itself from federal regulations, provided the means and the methods used to effectuate that objective are allowable under the law. Nor has the federal securities law placed profit-making or shrewd business tactics designed to benefit insiders, without more, beyond the pale. Those laws * * * are satisfied if a full and fair disclosure is made * * *."

The unbroken line of decision in the Southern District of New York rejecting challenges to going-private transactions under Rule 10b-5 is in accordance with this Court's decision in *Popkin* v. *Bishop*, 464 F.2d 714 (1972), which is also dispositive of this appeal. *Popkin* was a derivative suit brought by stockholders of Bell Intercontinental Corporation under Rule 10b-5 to enjoin a proposed merger of Bell and its two subsidiaries into The Equity Corporation. The plaintiff contended that in proposing unfair exchange ratios for the merger, Equity and various officers and directors had breached a variety of fiduciary duties, entitling

plaintiff to injunctive relief under Rule 10b-5. Judge Ryan dismissed the complaint, and this Court unanimously affirmed, holding that if there has been full and accurate disclosure there is no violation of Rule 10b-5.

Plaintiffs seek to dismiss this dispositive authority by contending that each of the six District Court judges who decided the cases cited above misread this Court's decision in *Popkin*, and that *Popkin* does not extend to merger cases in which there is no demonstrated business purpose. This Court's decision in *Popkin* is not thus limited, however, as is demonstrated not only by the explicit language in *Popkin* itself but also by this Court's affirmance *per curiam* (514 F.2d 283) of Judge Carter's decision in *Kaufmann* v. *Lawrence, supra*, 386 F. Supp. 12; Judge Carter had held, in express reliance on *Popkin*, that Rule 10b-5 is not violated where full and fair disclosure is made. Plaintiffs also suggest that *Popkin* does not apply here because the proposed merger is invalid under New York law due to the lack of business purpose (Plaintiffs' Brief pp. 32-33); this argument is groundless since the merger is valid under New York law, as we show in Point II.*

Plaintiffs cite this Court's decision in *Drachman* v. *Harvey*, 453 F.2d 722 (1972), for the proposition that Rule 10b-5 is violated where "the insiders had caused a corporation to purchase securities *for no business purpose*,

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* Moreover, as Judge Frankel recently ruled in Tanzer Economic Associates, Inc. v. Haynie, *supra*, 388 F. Supp. at 369, lack of business purpose is not relevant for the purposes of Rule 10b-5:

> "Similarly lacking in substance is the argument that LTV's business purpose was falsely stated to conceal the lack of a business purpose of J&L for the merger. The alleged falsity is bald assertion. *The absence of a J&L purpose is, for federal purposes at least, a matter of no consequence.*" (Emphasis added.)

but merely to perpetuate their control" (Plaintiffs' Brief p. 33). But the *Drachman* case did not concern the absence of business purpose. It held that a corporation which was the victim of fraud and deception in its capacity as a purchaser of its own securities had a cause of action under Rule 10b-5 which could be asserted derivatively.

Plaintiffs also claim that the court below "did not give proper effect to this Court's decision in *Schlick* v. *Penn-Dixie Cement Corp.*," 507 F.2d 374 (1974), *cert. denied*, 43 U.S.L.W. 3614 (U.S. May 19, 1975). *Schlick* has no application here, since it involved an issue of pleading, rather than, as here, a question whether a showing has been made sufficient to support the issuance of a preliminary injunction. In *Schlick*, the Court held that a complaint containing numerous well-pleaded allegations of misuse of corporate assets, excessive inter-company charges and manipulation of the market price of the stock of the merged corporation, all for the purpose of reducing the exchange ratio in a merger, stated a cause of action under Rule 10b-5.

Similarly, in *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546 (2d Cir. 1967), this Court stated, with respect to a complaint which alleged manipulation of the market price by keeping dividends at a minimum in order to force stockholders to sell at depressed prices, that "the contention that this states a claim under Rule 10b-5 is substantial." The issue in the present case, however, is not whether such allegations can state a cause of action under Rule 10b-5 but whether plaintiffs have made a sufficient factual showing to support a preliminary injunction. They have not made any such showing, and we have demonstrated (pp. 16-17, *supra*) that their claim is baseless.

Since there has been full and complete disclosure, and no fraud or deception of any kind has been shown, the unanimous line of decisions in this Circuit make it clear that the proposed merger does not violate Rule 10b-5 and that the District Court was correct in so holding.

POINT II

The proposed merger is expressly authorized by the New York Business Corporation Law and does not violate any legal rights of, or breach any duty owed to, the minority stockholders of Concord under New York law.

Section 902 of the Business Corporation Law by its terms permits a merger where, as here, the stock of one of the constituent corporations is to be converted into cash. The authorization is contained in section 902(a)(3), which provides that the Plan of Merger shall set forth:

> "The terms and conditions of the proposed merger or consolidation, including the manner and basis of converting the shares of each constituent corporation into shares, bonds or other securities of the surviving or consolidated corporation, *or the cash or other consideration to be paid or delivered in exchange for shares* of each constituent corporation, or a combination thereof." (Emphasis added.)

In accordance with this provision, the Plan of Merger adopted by Concord and AFW (97) provides that each share of AFW stock shall be converted into one share of stock of Concord (the surviving corporation), and that each share of Concord stock (other than that owned by AFW, which is to be cancelled) shall be converted into $3 in cash.

The rights of the minority stockholders are protected by B.C.L. §910, which provides that a stockholder who does not assent to the merger is entitled to judicial determination of the "fair value" of his shares in an appraisal proceeding. The procedure by which a stockholder invokes his appraisal rights is described in B.C.L. §623, which provides, among other things, that unless a dissenter can demonstrate that the merger is "unlawful or fraudulent as to him", an appraisal is his exclusive remedy. B.C.L. §623 (k).

Statutes permitting the so-called "freeze-out" of minority shareholders are not new. Prior to the enactment of the Business Corporation Law in 1963, the Stock Corporation Law had for many years permitted the conversion of the stock of one constituent corporation into "shares or *other securities*" of the surviving corporation (Stock Corp. Law §86), thus permitting the elimination of the *equity* interest of minority stockholders. Furthermore, ever since 1949, the statute has permitted one corporation which owned 95% or more of the stock of another to merge the latter and pay cash to the minority shareholders, thereby eliminating their entire interest in the corporation (Stock Corp. Law §85; B.C.L. §905); the provisions of B.C.L. §902 extended this procedure to all mergers.

The foregoing statutory scheme which expressly permits the elimination of the equity interest of the minority stockholders but assures them of the right to receive the "fair value" of their stock as judicially determined in appraisal proceedings has been unanimously sustained by the courts. *Beloff* v. *Consolidated Edison Co.*, 300 N.Y. 11,

87 N.E.2d 561 (1949); *Willcox v. Stern*, 18 N.Y.2d 195, 273 N.Y.S.2d 38, 219 N.E.2d 401 (1966); *Blumenthal v. Roosevelt Hotel, Inc.*, 202 Misc. 988, 115 N.Y.S.2d 52 (Sup. Ct. 1952).

In *Beloff v. Consolidated Edison Co., supra*, 300 N.Y. 11, 87 N.E.2d 561, a minority stockholder challenged a so-called freeze-out merger, contending (a) that the minority stockholders were "entitled to the preservation of their interest in the corporate assets and business as a going concern * * * on the same terms as the majority" (300 N.Y. at 14), and (b) that otherwise the provisions of section 85 of the Stock Corporation Law (the predecessor of B.C.L. §905), permitting a corporation which owned 95% or more of the stock of another to merge the latter and pay cash to the minority stockholders, would violate the due process, contract and equal protection clauses of the Constitution (300 N.Y. at 13-14, 19). The Court of Appeals unanimously rejected the arguments, holding (300 N.Y. at 19, 87 N.E.2d at 564):

> "It is fully as well settled that if the merger (or consolidation) is duly consummated in accordance with the statutes, the remedy of appraisal and payment is the only one available to dissenting shareholders, and that such dissenters on such appraisals are entitled to receive fair and full compensation for all their rights. [Cases cited.] * * * *In short, the merged corporation's shareholder has only one real right; to have the value of his holding protected, and that protection is given him by his right to an appraisal.* [Case cited.] *He has no right to stay in the picture, to go along into the merger, or to share in its future benefits.*" (Emphasis added.)

And in *Willcox* v. *Stern*, *supra*, 18 N.Y.2d 195, 273 N.Y.S.2d 38, 219 N.E.2d 401, in response to another challenge to the constitutionality of "freezing out" minority stockholders, the Court of Appeals again unanimously upheld the validity of a merger in which minority stockholders were paid cash for their shares but had appraisal rights. Relying on *Beloff*, *supra*, the Court concluded (18 N.Y.2d at 202, 273 N.Y.S.2d at 43, 219 N.E.2d at 404):

> "So long as the value of petitioner's interest is compensable, he has no constitutionally protected right to continue as a stockholder."

Plaintiffs argue that *Beloff* and *Willcox* are limited to short-form mergers under B.C.L. §905. That argument and the other state law arguments made by plaintiffs were conclusively rejected by Chief Judge (then Justice) Breitel, in *Blumenthal* v. *Roosevelt Hotel, Inc.*, *supra*, 202 Misc. 988, 115 N.Y.S.2d 52. In that case minority stockholders of Roosevelt Hotel, Inc., a corporation controlled by the Conrad Hilton interests, sought to enjoin the sale of the hotel's assets to a subsidiary of Hilton Hotels Corporation. The plaintiffs there alleged—as plaintiffs do here—that the business had been prosperous and had even better prospects, and that the price was inadequate and had been brought about by self-dealing. They also alleged—as the plaintiffs do in this case—that the sale was not in the interest of either the corporation or the minority stockholders, and that its purpose was merely to eliminate the minority. They argued—as plaintiffs do here—that because the transaction was not in the corperate interest and would benefit the majority, it should be enjoined; in support of this argument they cited—as plaintiffs do here—

Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919).

Judge Breitel denied a temporary injunction and dismissed the complaint, holding (a) that the majority's purpose to eliminate the minority did not render the transaction fraudulent or illegal since the minority did not have a right to remain as stockholders and since the value of their stock was protected by the appraisal remedy which was available, and (b) that the minority stockholders' exclusive remedy was under the appraisal statute. His decision is a conclusive answer to plaintiffs' state law claims on this appeal.

The opinion in *Blumenthal* first completely distinguishes the *Kavanaugh* case, and the distinctions articulated are equally applicable in the present case. In *Kavanaugh* the corporation was closely held and the defendants were motivated by personal animus toward the plaintiff and were found by the court to have proposed the transaction in order to depreciate the value of the plaintiff's interest in the corporation. More significantly, however, there was at the time no statute providing for appraisal, so that if the transaction were consummated the defendants would have accomplished their goal of irremediably reducing the value of the plaintiff's stock. As Judge Breitel stated (202 Misc. at 990-991, 115 N.Y.S.2d at 55):

> "Involved in the *Kavanaugh* case (supra) was a closed corporation, a scheme and plan to squeeze out the plaintiff * * * for the alleged purpose of depreciating the value of the corporate property and the plaintiff's proportional interest in it. As a consequence, if

plaintiff proved his allegations, he would have shown that the value of his stock would have been irretrievably reduced in value or destroyed * * * [T]here was no right in dissenting stockholders to procure an appraisal of their stock. Unless the remedy in equity was provided, plaintiff's property would inevitably be adversely affected.

"* * * [T]he situation that we have in the instant case is not the same as that involved in the *Kavanaugh* matter.

"In this case * * * statutes provide a remedy to dissenting stockholders to procure an appraisal * * * It has been decided that where dissenting stockholders have such a remedy, it is an exclusive one. (*Anderson v. International Minerals & Chemical Corp.*, 295 N.Y. 343; *Beloff v. Consolidated Edison Co. of N.Y.*, 300 N.Y. 11)."

He then added (202 Misc. at 992, 115 N.Y.S.2d at 56):

"A reading of the authorities, such as the *Anderson* and *Beloff* cases, compels the conclusion that if the *Kavanaugh* case were now to be decided and if * * * a minority stockholder would have a right to have his stock appraised * * * that complaint would have to be dismissed. The reason would be that no longer could it be said that the plaintiff had no remedy available at law, under which he could receive the full value of his stock."

Judge Breitel next rejected the argument that the *Kavanaugh* case should apply despite the existence of appraisal rights, because bad faith and illegality were involved, saying (202 Misc. at 991, 115 N.Y.S.2d at 55-56):

"They [plaintiffs] argue that where the bad faith affects the invocation of the statutory procedure, the

statutory procedure itself is affected with illegality and as a result will not have the effect of limiting the dissenting stockholder to the appraisal procedure as an exclusive remedy. This would be true if plaintiffs had alleged and could show that the statutory procedure was being deliberately used as one of the instruments of defrauding the plaintiffs *by, and with that intention, reducing or destroying the value of their stock. The crux is whether the depreciation of plaintiffs' stock is without remedy. That was the situation in the Kavanaugh case. That is not the situation where the appraisal procedure is available to the dissenting stockholder. The difference is due to the fact that in an appraisal proceeding the stockholder is entitled to the full value of the stock* * * *." (Emphasis added.)

Finally, Judge Breitel squarely rejected the contention —which is the cornerstone of plaintiffs' state law claim on this appeal—that the majority's use of its control to eliminate the minority stockholders and thus to benefit itself, without more, rendered the transaction illegal. Noting that the same argument had been presented in *Beloff* and rejected by the Court of Appeals, he stated (202 Misc. at 993, 115 N.Y.S.2d at 57):

> "Nor is an issue of illegality tendered in this case. Merely the use of the words 'bad faith' will not raise such an issue. *Merely to seek to eliminate minority stockholders does not tender such an issue.* Illegality would be tendered if the scheme used were such, whether with the use of the statute or without, as to effect a *fraudulent injury to the value of plaintiff's stock not reparable by a remedy at law.*" (Emphasis added.)

The thorough, well-reasoned and fully supported opinion in *Blumenthal* is dispositive of every argument made

by plaintiffs on their state law claims. Plaintiffs' only answer to the controlling effect of the *Blumenthal* decision in this case is to argue that it has been "narrowly limited, if not effectively overruled" by *Eisenberg* v. *Central Zone Property Corp.*, 306 N.Y. 58, 115 N.E.2d 652 (1953). (Brief p. 28). *Eisenberg* does not have any bearing on *Blumenthal*, however, and does not limit or overrule it, either expressly or by implication. In *Eisenberg*, a New York corporation proposed to transfer all of its assets to a new Delaware corporation in exchange for the stock of that corporation, which would be transferred to a voting trust, following which the New York corporation would dissolve and distribute the voting trust certificates to its stockholders. The Court of Appeals held that the transaction was not authorized by section 20 of the Stock Corporation Law, relating to the sale of corporate assets, and sections 105 and 106, relating to dissolution, since there was not to be, as the statutes required, a pro rata distribution of the stock received on the sale, but rather a mesne conveyance to voting trustees and a distribution of voting trust certificates. Since the transaction was invalid, it could be enjoined, and appraisal was not the exclusive remedy. The decision has no bearing on the holding in *Blumenthal* that where, as here, the transaction is expressly authorized by statute the appraisal remedy is exclusive.

The other cases cited by plaintiffs are likewise inapplicable. For example, *Foley* v. *D'Agostino*, 21 App. Div. 2d 60, 248 N.Y.S.2d 121 (1st Dep't 1964), held that officers and directors of a corporation could not engage in direct competition with it through a separate corporation in which they were interested. *Bryan* v. *Brock & Blevins Co.*, 490

F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974), purported to decide the validity of the merger under *Georgia* law, and in any event did not cite a single case from that or any other state.

The authoritative New York decisions thus make it clear that the plan to return Concord to a privately-held corporation is expressly authorized by the New York statutes and does not violate a fiduciary or any other duty of the Weinsteins to the public shareholders of Concord.

POINT III

The District Court properly denied plaintiffs' motions for a preliminary injunction on the ground that they have an adequate remedy at law.

As expressly held by the court below (133), plaintiffs failed to demonstrate either that they would suffer irreparable injury or that the balance of hardship tips in their favor. For that reason alone, their motions for a preliminary injunction were correctly denied.

The minority stockholders of Concord who are not satisfied with the $3 per share that they will receive pursuant to the merger have the right to obtain a judicial determination of the value of their stock in an appraisal proceeding. B.C.L. §§910 and 623. In that proceeding, "* * * every right of a dissenting shareholder is to be appraised and paid for." *Anderson* v. *International Minerals & Chemical Corp.*, 295 N.Y. 343, 350, 67 N.E.2d 573, 577 (1946); *Beloff* v. *Consolidated Edison Co.*, 300 N.Y. 11,

20, 87 N.E.2d 561, 565 (1949). The appraisal right, or the right to money damages in a federal or state action, affords plaintiffs an adequate remedy at law. *Voege* v. *Smith*, 329 F. Supp. 180, 184 (S.D.N.Y. 1971).

In two recent cases challenging "going private" transactions, it has been held that money damages are an adequate remedy. In *Tanzer* v. *Economic Associates, Inc.* v. *Haynie, supra*, 388 F. Supp. 365, Judge Frankel denied a motion for a preliminary injunction against such a merger in part on the ground that plaintiff had an adequate remedy at law, stating (at 369):

> "In the longer run, should plaintiff prove correct, there is a sufficiently adequate remedy at law. If 'sufficiently adequate' is ungainly English, it is intentional. The remedy is not perfect. If somewhat romanticized, plaintiff's argument that shareholders should not be 'frozen out' of their corporation is not weightless. Money damages will not thaw shareholders thus afflicted. But that remedy, on balance, given the estimate of success, seems enough in the circumstances."

Similarly, in *Kaufmann* v. *Lawrence, supra*, 386 F. Supp. 12, *aff'd per curiam*, 514 F.2d 283, as one basis for denying a preliminary injunction against an exchange transaction under which plaintiff's equity interest would be eliminated, Judge Carter concluded that damages were an adequate remedy at law, stating (at p. 17):

> "Finally, it should be added that even if I am in error as to the reach of the federal securities laws, the plaintiff and the class he represents have an adequate remedy at law. Monetary damages will suffice to make them whole."

Conclusion

For the foregoing reasons, the order of the District Court denying plaintiffs' motions for a preliminary injunction should be affirmed.

Dated: New York, New York
August 22, 1975

Respectfully submitted,

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